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# Directive 02-8: TRAC Leases

Introduction: "TRAC Leases" are commercial leases for fleets of motor vehicles that contain a provision called a Terminal Rental Adjustment Clause. This clause provides for an adjustment (either an additional payment from the lessee to the lessor or a refund to the lessee from the lessor) based on the difference between the projected value of each leased vehicle and its actual value at the time of lease termination.

Issue: For sales tax purposes, how should a lessor treat an adjustment at the end of a TRAC Lease?

Directive: An additional payment due from the lessee to the lessor as the result of a TRAC adjustment is part of the total consideration for the lease subject to sales tax and must be included in the lessor's gross receipts for the period in which the additional payment is due. A refund from the lessor to the lessee as the result of a TRAC adjustment may be deducted from the lessor's gross receipts in the period the refund is paid or credited to the lessee, provided that the vendor refunds or credits the corresponding amount of sales tax to the lessee at the time the TRAC refund or credit is given to the lessee.

Discussion of Law:

Massachusetts imposes an excise upon all retail sales of tangible personal property and telecommunications services in Massachusetts by a vendor unless otherwise exempt. The definition of "sale" includes any transfer of title or possession, or both, for a consideration including leases or rentals of tangible personal property. Where applicable, the excise is imposed at the rate of five percent of the gross receipts of the vendor from all taxable sales, except as otherwise provided. "Gross receipts" are defined as the total sales price received by a vendor as consideration for a retail sale. G.L. c. 64H, ss. 1, 2.

The sales price on which tax is calculated is generally the total amount paid by a purchaser to a vendor as consideration for a retail sale, valued in money or otherwise. G.L. c. 64H, s. 1. Each period for which a motor vehicle lease or rental payment is charged is considered a completed retail sale for the purpose of imposition, collection, and payment of sales tax. The sales price on which the tax is computed for each period is the total lease or rental charges for that period. See 830 CMR 64H.25.1(9).

Terminal Rental Adjustment Clauses are used in commercial leases for fleets of motor vehicles. A Terminal Rental Adjustment Clause is defined in the Internal Revenue Code as "a provision of an agreement which permits or requires the rental price to be adjusted upward or downward by reference to the amount realized by the lessor under the agreement upon sale or other disposition of such property." 26 U.S.C. 7701(h)(3). Under both federal tax law and Massachusetts law, TRAC leases are treated as leases rather than conditional sales or financing arrangements. 26 U.S.C. 7701(h)(1) and G.L. c. 90D, s. 21A.(1)

The Massachusetts sales tax is based on a vendor's gross receipts for a period. TRAC adjustments that result in an additional payment from the lessee to the lessor will increase a vendor's taxable gross receipts for the period in which the additional payment is due. TRAC adjustments that result in

a refund to the lessee may be subtracted from the lessor's gross receipts for the period in which the refund is made, thereby reflecting the adjustment to the total rental price or consideration for the lease as described in G.L. c. 90D, s. 21A.

/s/Alan L. LeBovidge  
Alan L. LeBovidge  
Commissioner of Revenue

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Footnotes:

1. Section 21A provides, "In the case of motor vehicles or trailers, notwithstanding any other provision of law to the contrary, a transaction does not create a sale or security interest merely because it provides that the rental price is permitted or required to be adjusted under the agreement either upward or downward by reference to the amount realized upon sale or other disposition of the motor vehicle or trailer." ([return to text](#))